

General Information Letter: General discussion of withholding issues when employee changes residence to Illinois without informing the employer.

December 2, 2002

Dear:

This is in response to your letter dated October 28, 2002 in which you request a letter ruling. The nature of your request and the information you have provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.Iltax.com.

In your letter you have stated the following:

We would like to have your guidance and ruling concerning W2c's and filing amended returns. Each year, we have employees who change their work and/or home address after the end of the normal year-end (12/31/02).

The following is a typical scenario:

1. An employee enters our computer system and changes his work and home address on April 30, 2002.
2. Our system immediately sends a notification to the payroll processing team indicating that the employee's tax liability needs to be checked and possibly changed. (This particular employee has viewed his pay stub electronically so he is not sent a pay stub on payday at his work address, which might trigger the idea to change his address on the computer.)
3. This change was effective 07/15/02. We must correct his employee pay record to reflect that this change is effective on the correct date (07/15/02) and move the taxes as appropriate. (We have no way to check that the home and work addresses are accurate.)
4. This action creates a W2c, which is then sent to the employee and an amended return is filed with each state.
5. If this employee has his taxes withheld moved to Illinois, we then issue a check to pay the taxes to Illinois.

Here is where we need your guidance. We file an amended Illinois return and enclose the appropriate W2c's, effective 12/31/02 but processed and paid on April 30, 2003. Illinois then processes our amended return and sends us a notice that we owe penalty and interest because we did not file timely.

Because of the fact that we have no control over when we are notified of these changes in tax liability, we do not feel that we should be charged penalty and interest. Will your office please respond to this situation and let us know if you have any solution to our dilemma?

RULING

Section 701 of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 *et seq.*) sets forth the requirements relating to an employer's withholding of Illinois income tax. Subsections (a) and (b) of that section state as follows:

(a) In General. Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold a tax on:

(1) compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual; or

(2) payments described in subsection (b) shall deduct and withhold from such compensation for each payroll period (as defined in Section 3401 of the Internal Revenue Code) an amount equal to the amount by which such individual's compensation exceeds the proportionate part of this withholding exemption (computed as provided in Section 702) attributable to the payroll period for which such compensation is payable multiplied by a percentage equal to the percentage tax rate for individuals provided in subsection (b) of Section 201.

(b) Payments to Residents. Any payment (including compensation) to a resident by a payor maintaining an office or transacting business within this State and on which withholding of tax is required under the provisions of the Internal Revenue Code shall be deemed to be compensation paid in this State by an employer to an employee for purposes of Article 7 and Section 601(b)(1) to the extent such payment is included in the recipient's base income and not subjected to withholding by another state.

Department of Revenue Regulations Section 100.7010(b)(1) explains the relevance of an employee's place of residence with respect to the employer's withholding obligation.

In general, except in the limited circumstances referred to in subsection (a)(1)(C) [base of operations not in any state where service is performed] and subsections (b)(2) and (b)(3) [federal law affects Illinois withholding authority], the place of residence of any employee is irrelevant to the determination of "compensation paid in this State," and, therefore, whether withholding is required with respect to such employee. However, compensation paid to residents that would not otherwise be considered "compensation paid in this State" applying the definition in IITA Section 304(a)(2)(B) may be deemed compensation paid in this State under IITA Section 701(b) and therefore be subject to withholding in accordance with Section 100.7030 of this Part. In addition, compensation paid to residents of a state with which Illinois has entered into a reciprocal agreement (see Section 100.7090) and that would be considered "compensation paid in this State" applying the rules of IITA Section 304(a)(2)(B) is exempt from withholding.

Accordingly, an employee's change of residence generally does not affect an employer's withholding obligation. In addition, a change of the location where the employee performs services may affect the employer's withholding obligation with respect to "compensation paid in this State."

Under IITA Section 704, every employer required to deduct and withhold tax must file a return and pay such tax as provided in that section.

Section 1004 of the IITA imposes a penalty for failure to file withholding returns or annual transmittal forms for wage and tax statements as follows:

In addition to any other penalties imposed by this Act, a taxpayer failing to file a quarterly return or the annual transmittal form for wage and tax statements required by Section 704 or regulations promulgated thereunder shall incur a penalty for each such failure as prescribed by Section 3-3 of the Uniform Penalty and Interest Act.

Section 1005 of the IITA imposes a penalty for underpayment of tax as follows:

If any amount of tax required to be shown on a return prescribed by this Act is not paid on or before the date required for filing such return (determined without regard to any extension of time to file), a penalty shall be imposed in the manner and at the rate prescribed by the Uniform Penalty and Interest Act.

Section 3-3 of the Uniform Penalty and Interest Act ("UPIA" ; 35 ILCS 735/3-3) provides for the calculation of the penalty for failure to file or pay.

Section 1002(e)(3) of the IITA states the manner in which the penalty imposed under IITA Section 1004 shall be assessed.

The penalty imposed by Section 1004 will be asserted by the Department's issuance of a notice of deficiency. If taxpayer files a timely protest, the procedures of Section 908 will be followed. If a taxpayer does not file a timely protest, the notice of deficiency will constitute an assessment pursuant to subsection (c) of Section 904.

Section 1003 of the IITA imposes interest on a deficiency of tax. The Section states in pertinent part as follows:

(a) In General. If any amount of tax imposed by this Act, including tax withheld by an employer, is not paid on or before the date prescribed for payment of such tax (determined without regard to any extensions), interest on such amount shall be paid in the manner and at the rate prescribed in Section 3-2 of the Uniform Penalty and Interest Act for the period from such date to the date of payment of such amount.

(b) Interest treated as tax. Interest prescribed under this Section on any tax, including tax withheld by an employer, or on any penalty, shall be deemed assessed upon the assessment of the tax or penalties to which such interest relates and shall be collected and paid on notice and demand in the same manner as tax. Any reference in this Act to the tax imposed by this Act shall be deemed also to refer to interest imposed by this Section on such tax.

Section 3-8 of the UPIA states that the penalty for failure to file or pay shall not apply if the taxpayer demonstrates that such failure was due to reasonable cause.

The penalties imposed under the provisions of Sections 3-3, 3-4, 3-5, and 3-7.5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. A taxpayer may protest the imposition of a penalty under Section 3-3, 3-4, 4-5, or 3-7.5 on the basis of reasonable cause without protesting the underlying tax liability.

Section 2505/2505-250 of the Civil Administrative Code of Illinois relates to the compromise of debts due the State of Illinois. Pursuant to such section, the Department has established a Board of Appeals to review Department actions in controversies involving the determination of liability for Illinois income tax, including penalties and interest. (86 Ill. Adm. Code 210.101 *et seq.*) Pursuant to Department of Revenue Regulations section 210.101, review before the Board of Appeals requires the filing of a written petition. In addition, the regulations set forth specific provisions for the Board of

Appeals regarding offers in compromise and waivers of penalty and interest. (See 86 Ill. Adm. Code 210.120) For your convenience, enclosed please find copies of the relevant regulations.

Except as set forth above, the Department is without authority to exempt a taxpayer from interest or penalty imposed under the IITA. Accordingly, you may protest the imposition of penalty pursuant to IITA Section 908 and/or petition the Board of Appeals as appropriate.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have further questions regarding this GIL, please call (217) 782-7055. If you have additional questions regarding Illinois income tax laws, please visit the Department's web site at www.il.tax.com.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)